FOR THE NINTH CIRCUIT

FRANK P. McKINNEY, as Receiver of the OLYMPIA BANK & TRUST COMPANY, a Corporation,

Appellant,

vs.

UNITED STATES NATIONAL BANK OF CENTRALIA, a Corporation, and A. R. TITLOW, as Receiver of the UNITED STATES NATIONAL BANK OF CENTRALIA,

Appellees,

and

C. S. REINHART and C. WILL SHAFFER, Stockholders of OLYMPIA BANK & TRUST COMPANY, a Corporation, for Themselves and All Other Stockholders of Said Company,

Appellants,

vs.

UNITED STATES NATIONAL BANK OF CENTRALIA, a Corporation, and A. R. TITLOW, as Receiver of the UNITED STATES NATIONAL BANK OF CENTRALIA,

Appellees,

and

ROY A. LANGLEY, as Receiver of the STATE BANK OF TENINO,

Appellant,

vs.

UNITED STATES NATIONAL BANK OF CENTRALIA, a Corporation, and A. R. TITLOW, as Receiver of the UNITED STATES NATIONAL BANK OF CENTRALIA,

Appellees.

PETITION FOR RE-HEARING

C. WILL SHAFFER,
Solicitor for Interveners.

P. M. TROY,
R. M. STURDEVANT,
Solicitors for Receiver of the Olympia Bank & Trust Company.

The Washington Standard Print Olympia, Washington.

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cause, and to modify the same in accordance with the prayer hereof.

INTERVENERS' POSITION.

Your petitioners, the interveners, after the deluge of financial disaster had spent its crest and they had surveyed the wreckage, demanded that the receiver of the Olympia bank should claim from the ruins:

First: That the basis of credit for the $50,000 certificate was a valid bankable basis, and the certificate estopped the bank to question it;

Second: That the investigation made by the State Bank Examiner and the charter issued by him were conclusive to all the world as to that credit and the lawful payment of the capital stock; and

Third: That if the above propositions were not governing, then a fraud had been practiced upon the state and the creditors by the officers of the United States National Bank, and such bank had been the beneficiary of that fraud and as such must make restitution.

The receiver of the Olympia bank refused the contentions of interveners as set forth, whereupon they sought and obtained an order from the court appointing such receiver, the right to intervene. In their

above, as the first two named were in substantial accord with the claims of the receiver.

COURT FINDS FOR INTERVENERS.

With their cause of action your Honors find:

> "that the authority of the Olympia bank to open its doors and engage in a banking business was fraudulently obtained, that its capital was not paid in cash as required by law, and that the cashier and manager of the Centralia bank participated in the fraud . . . Hays had no right to receive the deposits, and no right to transfer them to another bank, nor had the Centralia bank the right to receive them."

But your Honors hold we are not entitled to a preference by reason of the fact that the parties who perpetrated the fraud, by the ingenuity of their fraudulent transactions, put us within a rule of law that bars us from a preference—they took the bulk of our deposits by a circuitous route instead of directly to the Centralia bank.

In support of your inability as a matter of law to give us a preference, your Honors cite the cases of:

Titlow vs. McCormick, 236 Fed. 209, and

United States National Bank vs. Centralia, 240 Fed. 93.

distinguishable from the case at bar. In those cases no element of fraud appears. Our case is based entirely upon fraud.

> "Hays had no right to receive the deposits, and no right to transfer them to another bank, *nor had the Centralia bank the right to receive them.*"

Whereas in the cases cited, the transactions by which the United States National Bank came into possession of the funds in dispute were perfectly legitimate, were not tinctured with fraud, and subsequent creditors of the United States National Bank would have a right to consider them as existing assets and liabilities of the bank.

Fraud Changes Rule.

Not so with our funds. The Centralia bank got them by fraud and although not all traceable directly into the receiver's hands, they did go to swell the assets that came into his hands, and therefore the general creditors are getting the benefits of them.

That there was fraud is beyond dispute—the lower court found so and this court finds accordingly.

> "As between the immediate parties fraud makes *all things void* which are done under its

"A court of equity converts a party who has obtained property by fraud into a trustee for the party who is injured by the fraud."

Underhill on Trusts, p. 185 (Am. Ed. 186.)

And Perry says, a constructive trust always arises from actual fraud practiced by one man upon another.

See Perry on Trusts, Sec. 168.

Also Sec. 171, page 271.

Also Sec. 173, page 274.

Also Encyc. U. S. Supreme Court Repts, Vol. 11, p. 692.

Also Encyc. U. S. Supreme Court Repts, Vol. 6, p. 422.

These last citations are not unsupported by your Honors' opinion in this case. They are cited, however, in further support of petitioners' position.

Preference Only Issue.

The only issue here is the right of a preference to the remittances the Olympia bank sent to correspondent banks of the Centralia bank. There are several reasons why we think these remittances should be treated the same as the remittances sent direct to Centralia.

tlement with these correspondent banks; thus he takes credit for one hundred cents on the dollar, but by the decision will probably pay us back fifty. This statement can easily be verified by the records of the Centralia receiver.

Receiver Admits Getting Deposits.

Second: The Centralia receiver admits he received these remittances, his books show it, and he waived the necessity of us proving it at the trial. We think the rule here should apply which this court quotes so approvingly in the *Titlow vs. McCormick,* 236 Fed. 209, to-wit: *The Merchants' National Bank vs. School District,* 94 Fed. 705. There the court said:

> "It is undisputed that the money belonged to the school district and that it was deposited with the bank's correspondent in Boston and that, upon receipt of intelligence of such deposit, the Helena bank opened the account, and entered into the agreement which was indicated in the findings of the master. *The Helena bank, if it had not then the money in its actual possession, had it under its control, and could lawfully in due course*

Third: The remittances were made each day under the direct orders of the Centralia bank. The record shows that practically every day and sometimes several times a day, Gilchrist would call Hays on the phone or drive over to see him about deposits and would direct him where to send them. These remittances were all under the control of the Centralia bank before they left the Olympia bank.

REMITTANCES WERE TO CENTRALIA'S AGENT.

Fourth: The remittances were to the correspondent banks of the Centralia bank, which banks were the agents of the Centralia bank. And as your Honors approve in the McCormick case again the language in the School District case:

> "Neither the bank nor the receiver is now in a position to say that the *money received by the bank's agent"* (its correspondent in Boston) *"was not actually received by the bank."*
>
> See *Titlow vs. McCormick,* 236 Fed. on p. 213.

PUBLIC FUNDS.

Let us illustrate these claims by any one remittance. About $30,000 of the remittances were public funds (another reason why this amount should be

Michie says, that public funds are entitled to a preference in most jurisdictions.

Michie Banks & Banking, page 614.

ILLUSTRATION.

But take the $15,000 deposited by the State Treasurer:

Hays was urged by Gilchrist to get it;

He was told by Gilchrist where to send it. Hays then acted as the agent of Gilchrist, the manager of the Centralia bank;

It was sent to the correspondent, or agent of the Centralia bank and there credited to the Centralia bank, from the Olympia bank;

Notice of the remittance from the correspondent or agent bank was received by the Centralia bank and Olympia credited therewith. Centralia's assets were increased to the same extent as if Olympia had deposited the State Treasurer's draft directly in the correspondent bank and then sent a draft on the correspondent bank as a remittance to the Centralia bank;

THE FACTS.

Centralia received the benefit of the remittance,

Centralia by fraud puts Olympia in a position to receive the deposit, directs the receiving of the deposit, takes charge of it as soon as it is received, directs what agent to whom it shall be remitted, the agent credits the Centralia bank for the remittance, Centralia charges its agent and credits Olympia. Centralia uses the remittance to the relief of its creditors, using it for the full face, getting the full benefit of her fraud, without restitution to Olympia.

Tenino Account.

The same is true of every other remittance. Take the Tenino account. The record shows Centralia owed Tenino, but not now; the receiver of the Centralia bank will present the receiver of the Tenino bank a claim for $10,000 and by this decree has it established. Nor does the fact that Tenino will be unable to pay one hundred cents on the dollar, change the equities. Centralia would have been out $10,000 cash had Centralia sent Tenino the money. But Olympia sent it for Centralia. So Centralia is not hurt any more by giving us now one hundred cents on the dollar, for what we sent to Tenino, than she would be had she sent it directly to Tenino.

out of our remittances and is paying us fifty or so.

Nobody is hurt if we are all placed back where we were before Centralia engineered her fraud; the creditors of the Centralia bank are just where they would have been and we are in the same position except for the costs we were put to in starting our bank and in winding it up.

Tracing Funds Unnecessary.

We think that the tracing of the funds directly into the bank is not necessary where the element of fraud is present.

But even if it is necessary to trace them, the receiver's admission that he got them, the fact that their agent, their correspondent, did actually get them as in the School District case *supra* is sufficient in law to hold that they went directly to swell the assets of the receiver.

> "Neither a bank nor its receiver can deny the receipt of money deposited with the bank as a trust fund on the ground that no money was actually deposited, where it received and accepted credit for the amount with a correspondent and received the money thereon in due course of business."
>
> Michie on Banks & Banking, p. 904, Sec. 121

of one of its customers, to a third person, for the purpose of misleading him, it is liable for deceit if loss results."

1 Michie Banks and Banking, 683.

"Where a bank, through the fraud of its agent, obtained certain assets through another bank, though it is not liable criminally, yet it is liable civiliter, as it appointed the end, though not the means, and it cannot retain any advantages which had been gained through the agent."

Johnston vs. Southwestern R. Bank, 3 Strob. (S. C.) Eq. 263.

EQUITY.

The fundamental principle of equity that where one of two innocent parties must suffer by reason of a fraudulent transaction it must be the one whose acts or relations made the fraud possible, will be reversed if your Honors' decision stands. The creditors of the Centralia bank whose agent made it possible by a false credit to deceive the depositors of the Olympia bank get the full benefit of our defrauded depositors' money while the defrauded depositors get but half their money back.

lars in assets. By a fraud a third party is brought in with a thousand dollars in assets which went directly into the bank. On a forced liquidation, equity then says to the third party who was induced by fraud to put in his money, "you may have your money back, as these other creditors shall not profit by a fraud practiced upon you"; and to the other creditors, "you shall have only what would have been rightfully yours had not this fraud been committed."

But suppose the third party was by the ingenuity of the perpetrators of the fraud induced to give his assets to the agent of the perpetrator. The agent then delivers the assets to the principal. Now on a forced liquidation equity says to the first creditors: "By reason of a fraud practiced on a third party you may not only have what would have been yours had this fraud not have been practiced, but you may have a large share of the assets so acquired by fraud"; and to the defrauded party, "By reason of the defrauding party inducing you to hand your money to his agent, from whence he then obtained it, he and

We hope your Honors will pardon the simple illustration, but we think it fits the case if your decision is to stand. It may be the law, but it does not appear as equity.

"Although courts of equity have not made general definitions stating what is fraud and what is not, they have not hesitated to lay down broad and comprehensive principles of remedial justice, and to apply these principles in favor of innocent parties suffering from the fraud of others. These principles though firm and inflexible, are yet so plastic that they can be applied to every case of fraud as it occurs, however new it may be in its circumstances. The leading principle of this remedial justice is by way of equitable construction to convert the fraudulent holder of property into a trustee, and to preserve the property itself as a fund for the purpose of recompense. *In investigating allegations of fraud, courts of equity disregard mere technicalities and artificial rules, and look only to the general characteristics of the*

"An adverse doctrine would lead to the conclu sion that the grossest fraud might be practiced and fully proved in our courts of justice, and the law be found inadequate to relieve. But the arm of the law is not shortened, that it cannot save, and courts and jurors will with eagle eyes trace fraud through its secret and crooked paths, and render both, the agent who appears and the mover, who plots in darkness, amenable."

Windover vs. Hopkins, 2 Tyler (Vt.) I.

Receiver's Rights.

The receiver has no advantages the bank did not have, has no defenses the bank did not have.

"It may be stated at the outset that the receiver stands in the place of the bank whom he represents and has only such rights as it had, 'so that the rights of third parties are not increased, diminished or varied by his appointment.' In other words, he takes only such title to the assets as the bank itself had, subject to all the equities which existed against the assets in the hands of the bank. Therefore a bank receiver can not

frauds.

I Michie Banks & Banking, p. 542.

"Receivers, for the purpose of closing its concerns, have no rights superior to those which the bank would have had, if the management of its affairs had continued with its directors."

Lincoln vs. Fitch, 42 Me. 456.

If Gilchrist himself could not have successfully for his bank denied us a return of our funds after admitting that he got them, either directly or indirectly, then the receiver can not. The receiver can only do what his bank could do, and if his bank could not rescind without restitution, then the receiver can not.

Bennett vs. Judson, 21 N. Y. 238.

Assets Increased Is Rule.

If your Honors please, we think that in those jurisdictions which adhere most strictly to the rule of tracing funds or assets in order to establish a preference, none of them go as far as the decision now sought to be modified. Most of the text writers in support of the tracing rule, cite Iowa, yet Iowa says only:

"Under these authorities and many more that might be cited, the creditor who asks that his

estate, and that it may be taken therefrom without impairing the rights of general creditors."

First State Bank vs. Oelke, 149 Iowa 662 p. 667.

It is not asserted it should come directly. But does it come and swell the assets?

We have shown Centralia got our money. The receiver admits it (except the $10,000 to Tenino). The assets were increased, and our preference will not affect the general creditors beyond what they would have gotten had no fraud occurred.

If there is any doubt about any of these remittances not finally reaching Centralia, directly or indirectly, the doubt can be settled by returning the case to the lower court to ascertain that fact.

Results.

Centralia does not return Hays' notes. Hays is out of the state, outside of the jurisdiction of our courts. Several of the notes given to Hays by other would-be stockholders are probably not collectable. Several of the stockholders will not respond to a judgment on their statutory liability. In fact, if the bank was fraudulently organized, it was not organized at all in law, hence it is doubtful whether there

Hays had no right to receive deposits, he had no right to negotiate the notes, the notes may be void. The misled depositors of the Olympia bank have little to look to except what will be received from Centralia. They were defrauded, and shall they suffer while the depositors of the Centralia bank reach in and take a part of the funds the defrauded depositors of the Olympia bank put into the Centralia bank?

PRAYER.

We think nobody is hurt except those who will be stuck for the costs of the birth and struggling death of the Olympia bank, if your Honors modify your opinion to the effect of giving us a preference to the full extent to which our deposits swelled the assets of the Centralia bank, and the withdrawal of the same will not reduce the remaining assets below what they would have been had the Centralia bank not made possible such fraud.

In accordance with the above, we respectfully pray.

C. WILL SHAFFER
Solicitor for Interveners.

The above petition is approved and joined in by

R. M. STURDEVANT,

Solicitors for Receiver of the Olympia Bank & Trust Company.